

# SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Cardenas Analyst: Darrine Distefano Bill Number: AB 1257

Related Bills: See Prior Analysis Telephone: 845-6458 Amended Date: 01-16-2002

Attorney: Patrick Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Child Care Facility Credit/50% of Cost for Low-Income Facilities/Bank Loan Credit/FTB to Report to Legislature

DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended \_\_\_\_\_.

X AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

X AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as amended 04-26-2001.

X FURTHER AMENDMENTS NECESSARY.

DEPARTMENT POSITION CHANGED TO \_\_\_\_\_.

X REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED 04-26-2001 STILL APPLIES.

X OTHER - See comments below.

## SUMMARY

This bill would allow:

- A credit for contributions for building or expanding a child care facility (Child Care Facility Credit).
- A credit for banks and financial institutions for interest income earned on loans made for building or expanding a child care facility (Interest Income Credit).

This bill would require the Franchise Tax Board (FTB) to report on the Interest Income Credit upon request by the Legislature.

## SUMMARY OF AMENDMENTS

Under the Child Care Facility Credit provisions, the January 16th amendments:

- Delete "child care provider" from the definition of qualified taxpayer.
- Exclude expenditures claimed under the Employer Child Care Program Credit from the definition of "qualified expenditures."
- Eliminate the requirement that the Department of Social Services (DSS) certify how the taxpayer's contribution was used, and substitute the requirement that DSS certify the amount of the taxpayer's qualified expenditures.

Board Position:

|                  |                   |                      |
|------------------|-------------------|----------------------|
| <u>      </u> S  | <u>      </u> NA  | <u>      </u> NP     |
| <u>      </u> SA | <u>      </u> O   | <u>      </u> NAR    |
| <u>      </u> N  | <u>      </u> OUA | <u>  X  </u> PENDING |

Legislative Director

Date

Brian Putler

04/09/02

- Require the Franchise Tax Board (FTB) to verify that:
  - The taxpayer claiming the credit is a “qualified taxpayer.”
  - The expenditures claimed are “qualified expenditures.”
  - Any credits previously claimed are recaptured as required.

Under the Interest Income Credit provision, the January 16th amendments:

- Require that the bank or financial corporation must make the loan to qualified child care providers.
- Add credit carryover language.
- Delete the provision that would have disallowed the credit to any project receiving funding or a subsidy from the Child Care and Development Facilities Loan Guaranty or Direct Loans Funds.

The January 16, 2002, amendments also made various technical changes to these credits and added them to the list of credits that can reduce regular tax below the tentative minimum tax (TMT) for purposes of the alternative minimum tax (AMT) calculation. For individuals, the amendments also added the Adoption Costs Credit, Joint Custody Head of Household Credit, Taxpayers with a Dependent Parent Credit, and the Senior Head of Household Credit to this list.

The January 16<sup>th</sup> amendments resolved two of the department’s implementation considerations discussed in the department’s analysis of the bill as amended April 26, 2001, by:

- Requiring the DSS to certify the taxpayer’s “qualified expenditures” made to the child care provider under the Child Care Facility Credit; and
- Limiting the Interest Income Credit to loans made to child care providers.

However, the January 16th amendments raise additional concerns that are listed below.

Except for the recent federal law changes, the remainder of the department's analysis of the bill, as amended April 26, 2001, still applies.

## **POSITION**

Pending.

## **ANALYSIS**

### **1. CHILD CARE FACILITY CREDIT**

#### **FEDERAL LAW**

Other than the credit proposed under this bill, there are no comparable state credits to the new federal credit described below.

Beginning in 2002, the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) allows a tax credit for employers equal to 25% of employee child care expenses and 10% of child care resource and referral services expenses. The credit may not exceed \$150,000 each year.

Qualified child care expenses include costs paid or incurred (1) to acquire, construct, rehabilitate, or expand property that is to be used as part of the taxpayer's child care facility; (2) for the operation of the taxpayer's child care facility, including the costs of training and certain compensation for employees of the child care facility, and scholarship programs; or (3) under a contract with a child care facility to provide child care services to the taxpayer's employees.

Qualified child care resource and referral expenses are amounts paid or incurred under a contract to provide child care resource and referral services to the taxpayer's employees.

### IMPLEMENTATION CONSIDERATIONS

There are a substantial number of undefined terms, technical problems, and ambiguous words used throughout the bill. For example, the bill defines "child care provider" but repeatedly uses the term "qualified child care provider," which is undefined, making it unclear whether the two terms are intended to mean the same thing. Similarly, the term "child care facility" is used throughout, but the term defined is "qualified child care facility."

This bill permits child care providers who pay or incur qualified expenditures to claim the credit. This language is inconsistent with the bill's other requirements. For example, the bill requires the child care provider to provide information to the DSS and to the taxpayer. This requirement indicates that the child care provider and the taxpayer are two different people. For ease of implementation, the author may wish to clarify the requirements of the bill or redefine a qualified taxpayer to be consistent with the rest of the bill's language.

This bill requires the taxpayer to recapture the credit if the facility is no longer operated as a child care facility. This provision may be difficult to verify since the department would be auditing the taxpayer, not the child care facility. Also, this provision would penalize the taxpayer for circumstances that would generally be out of its control.

If the child care facility is not located by or in a low-income area, the child care provider must obtain approval to accept children from families qualifying for child care subsidies. It is unclear what agency would give this approval.

Clarification of these areas will make the bill's provisions more precise and easier to administer, as well as clearly informing both taxpayers and child care providers of their relative obligations under the bill.

### TECHNICAL CONSIDERATIONS

The bill requires the FTB to verify certain facts and ensure that the credit is recaptured when appropriate. These requirements are normal audit procedures for the department. This language is unnecessary and confusing. The author may wish to further clarify if the intent is to require FTB to monitor the taxpayer and the child care facility beyond its normal audit procedures.

## ECONOMIC IMPACT

### Revenue Estimate

Based on the data and assumptions below, this bill would result in revenue losses as shown in the following table:

| Estimated Revenue Impact                       |        |        |        |
|------------------------------------------------|--------|--------|--------|
| Years Beginning On or After<br>January 1, 2002 |        |        |        |
| Enactment Assumed After<br>June 30, 2002       |        |        |        |
| Fiscal Years                                   |        |        |        |
| (In Millions)                                  |        |        |        |
|                                                | 2002-3 | 2003-4 | 2004-5 |
| Child Care<br>Facility Credit                  | -\$8   | -\$11  | -\$12  |
| TMT Limitation                                 | Insig  | Insig  | Insig  |

\*Insig – Insignificant, less than \$100,000 annually

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

### Revenue Discussion

#### Child Care Facility Credit:

This revenue estimate has been revised from 2001 estimates based on the January 16, 2002, amendments and new data available from the California Child Care Resource and Referral Network.

The revenue loss from this bill would depend on the number and associated costs of new or expanded child care facilities, the number of taxpayers making contributions under the proposal and the amounts of such contributions, and the amount of tax liabilities available to offset these incentives.

The number of child care centers qualifying under this provision is projected to be 95% of the total new or expanded non-government, for-profit centers in California, i.e., 182 centers in 2002. The projected growth rate for these centers is 2% for 2000 through 2002 and 3% for 2003 through 2005. The growth rate projection is based on factors including real estate costs, child care center staffing and financing difficulties, and this bill's incentive effect. These factors were also considered in the estimate for centers that will expand existing facilities.

The projected number of qualified new centers per year ranges from 279 in 2002 to 296 in 2005. Approximately 50% of new centers are projected to be portables while the other 50% are projected to be stationary structures. Limitations of the bill were allowed for in determining the estimates for large corporate child care center operations.

Estimated tax liability is the main limitation for applying this credit, creating large credit carryovers. Available tax liabilities were determined using financial data available from existing child care centers. Most of the revenue impact is attributed to owner/operator expenditures. The impact from non-owner/operators making contributions is included in the revenue estimates as is the offset from foregone depreciation deductions. Of the projected 274 new or expanded qualified child care facilities in 2002, it is estimated that 25% or 68 facilities will receive three cash contributions averaging \$5,000.

The impact of disallowing duplication of expenses eligible under this bill and under the Employer Child Care Program Credit has been included in this estimate and is not expected to be significant.

Estimates were developed in coordination with child care system and facility experts at the National Economic Development and Law Center, the California Child Care Resource and Referral Network, and various state agencies.

Tentative Minimum Tax Credit Limitation:

The impact of the bill to allow the Adoption Costs Credit, Joint Custody Head of Household Credit, Taxpayers with a Dependent Parent Credit, the Senior Head of Household Credit, and these two new credits to reduce tentative minimum tax is projected to be insignificant.

**ARGUMENTS/POLICY CONCERNS**

There are different income criteria for the Child Care Facility Credit and the Interest Income Credit. The Facility Credit uses the term "low-income" and the Interest Credit uses the term "low-or moderate-income." While both identify the child's family income, it is unclear whether this difference is intentional or if the criteria should in fact be the same for both credits in the bill. The bill also uses the term "children from families eligible for child care subsidies" versus "30% of children from households with income at or below 75% of the local median income." Again it is unclear whether these different definitions are intentional in order to differentiate between the two credits. However, there is no penalty or other sanction imposed upon the child care provider for failing to comply with these requirements. Instead, the bill imposes a penalty on the taxpayer making the contribution if the child care provider fails to perform its obligations. This penalty would likely act as an obstacle to potential contributors due to the uncertainty of their ability to ultimately realize the economic benefit offered by the facility credit. The author may wish to consider adding a penalty or other sanction to be imposed directly upon the child care provider for their failure to perform their obligations under the bill's language, or alternatively re-evaluate the requirements imposed on the child care provider.

This bill allows a taxpayer to exclude expenditures claimed under the Employer Child Care Program Credit. However, the language can be interpreted to allow the taxpayer to claim the remaining expenditures under this bill. Recent legislation has replaced language that requires taxpayers, when expenditures qualify for more than one credit, to make an election with a provision limiting the taxpayer to one credit with respect to qualified expenditures. This change allows taxpayers to make the choice of which credit to take on either the original or an amended return. This bill would require taxpayers to make an election on the original return. The author may wish to clarify that all expenditures claimed under the Employer Child Care Program Credit cannot be claimed under this bill.

## 2. INTEREST INCOME CREDIT

### IMPLEMENTATION CONSIDERATIONS

The term “qualified child care providers” is not defined for this credit. The author may wish to add a definition to clarify the type of child care provider that is qualified for the credit.

The bill would disallow the credit based upon the occurrence of certain future behavior of the borrower or, if the borrower is not a child care provider, someone other than the borrower. The occurrence of a disallowing event would be extremely difficult to determine because neither the taxpayer nor the bank have to provide any substantiation that a disallowing event has occurred.

### **ECONOMIC IMPACT**

#### Revenue Estimate

Based on the data and assumptions below, this bill would result in revenue losses as shown in the following table:

| Estimated Revenue Impact    |        |        |        |
|-----------------------------|--------|--------|--------|
| Years Beginning On or After |        |        |        |
| January 1, 2002             |        |        |        |
| Enactment Assumed After     |        |        |        |
| June 30, 2002               |        |        |        |
| Fiscal Years                |        |        |        |
| (In Millions)               |        |        |        |
|                             | 2002-3 | 2003-4 | 2004-5 |
| Interest Income<br>Credit   | -\$2   | -\$4   | -\$6   |

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

#### Revenue Discussion

This bill would allow a credit of 25% of the interest income earned by a bank or financial corporation on loans used to finance the construction or expansion of a child care facility. The bill does not require lenders to provide a discounted interest rate or to base the credit on the amount of interest foregone. The 25% credit is projected to create larger revenue losses because of the larger interest amounts involved and the inherent incentive effect to lenders. This estimate is provided as a rule of thumb for every \$100 million in annual qualified loans and assumes an average commercial interest rate of 8%.

## **ARGUMENTS/POLICY CONCERNS**

Federal law prohibits discriminatory state taxation of interest on federal obligations. This bill provides a credit to banks and financial corporations for interest earned on loans relating to child care facilities, thereby arguably favoring such loans over federal obligations. Thus this credit, without a comparable credit counterpart for federal obligations, could be seen as making the state's franchise tax discriminatory in violation of federal law.

## **LEGISLATIVE STAFF CONTACT**

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